Proposed Statement of Financial Accounting Standards

Business Combinations and Intangible Assets

September 7, 1999

INTRODUCTION

1. APB Opinion No. 16, *Business Combinations*, provides for two methods of accounting for business combinations, the pooling-of-interests method (the pooling method) and the purchase method. Under the pooling method, the assets and liabilities recorded on the books of each combining enterprise are carried forward to the financial statements of the combined enterprise. No other assets or liabilities are recognized as a result of the combination; thus, the excess of the purchase price over the book value of the net assets acquired (the purchase premium) is not recognized. The income statements of the combined enterprise for the year of combination is presented as if the enterprises had been combined for the full year; all comparative financial statements are presented as if the enterprises had always been combined.

2. Under the purchase method, the acquiring enterprise recognizes the assets acquired and liabilities assumed based on their fair values, including assets and liabilities that may not have been recorded on the statement of financial position of the acquired enterprise. Any excess of the cost of the acquired enterprise over the fair value of the net assets acquired is recognized as goodwill. The income statement of the acquiring enterprise does not include the results of operations of the acquired enterprise prior to the acquisition date.

3. The pooling and purchase methods are not alternatives or substitutes for one another. Instead, a business combination that meets all of the 12 conditions specified in Opinion 16 must be accounted for using the pooling method, and a business combination that does not meet all of those conditions must be accounted for using the purchase method. Although the 12 conditions specified in Opinion 16 were intended to limit the use of the pooling method, use of that method has increased substantially in recent years. Enterprises frequently structure transactions to qualify for the pooling method and thereby avoid the earnings charges related to recognizing goodwill and other intangible assets acquired, as well as those related to the step-up in the basis of the other net assets acquired. This Statement amends Opinion 16 and requires all business combinations to be accounted for using the purchase method, thereby eliminating use of the pooling method.

4. APB Opinion No. 17, *Intangible Assets*, addresses the accounting for intangible assets, including those acquired in a business combination. Opinion 17 requires that the

costs recorded for intangible assets, including goodwill, be amortized over the expected period of benefit, subject to a maximum period of 40 years.

5. This Statement supersedes Opinion 17 and replaces the 40-year maximum amortization period for intangible assets other than goodwill with a presumption that the useful economic life is 20 years or less. However, this Statement reduces the 40-year maximum amortization period for goodwill to 20 years. This Statement changes the financial presentation requirements for goodwill charges (including amortization) and requires them to be preceded by a subtotal and presented on a net-of-tax basis as a separate line item on the income statement. In addition, this Statement provides guidance for identifying intangible assets.

6. The increase in merger and acquisition activity has brought greater attention to perceived flaws and deficiencies in Opinions 16 and 17, including deficiencies in the usefulness of the information provided about those transactions. Concerns about the amount of time the Securities and Exchange Commission (SEC) staff spends on inquiries related to those Opinions, particularly Opinion 16, were cited by a former SEC chief accountant in urging the FASB (the Board) to reconsider Opinions 16 and 17. The FASB's Financial Accounting Standards Advisory Council (FASAC) also supported reconsideration of Opinions 16 and 17, noting the opportunity for achieving convergence on how business combinations are accounted for internationally. The Board acknowledges the concerns that have been expressed about the flaws and deficiencies in those Opinions. The Board shares the concerns of the SEC staff, given the continued need to devote FASB staff and Emerging Issues Task Force (EITF) resources to inquiries about those Opinions, and shares FASAC's views about promoting international comparability of accounting standards, as that is part of the Board's mission.

7. This Statement has two parts: Part I addresses the method of accounting for business combinations, amends Opinion 16,[1] and supersedes or amends a number of its interpretations. Part II addresses the accounting for intangible assets, including goodwill, and supersedes Opinion 17 and its interpretations. This Statement carries forward the provisions in Opinion 17 related to internally developed intangible assets with editorial changes.[2] The Board has not reconsidered those provisions because they are outside the scope of its project on business combinations.

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[1]A version of Opinion 16 that reflects the proposed amendments to that Opinion is posted on the FASB web site at www.fasb.org.

[2]That guidance can be found in paragraphs 31 and 36.

8. This Statement also amends or supersedes other accounting pronouncements listed in Appendix E. Except as provided in that appendix, Part I of this Statement does not change the accounting guidance in Opinion 16 and its amendments and interpretations related to the purchase method of accounting for business combinations. In addition, Part I of this Statement does not change the status of the EITF issues that provide guidance on applying the purchase method.[3]

9. Most of the provisions in this Statement do not apply to past transactions. The provisions of Opinions 16 and 17 and their interpretations that continue to be relevant in accounting for past transactions, but that have been deleted or superseded by this Statement, are carried forward in Appendix D. That guidance is carried forward with editorial changes, without reconsideration by the Board. Some of that guidance (as well as EITF issues) may be reconsidered in another phase of the Board's project on business combinations.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Part I: Business Combinations

Scope

10. Part I of this Statement applies to all business combinations except those between not-for-profit enterprises.[4] For purposes of applying this Statement, a *business combination* occurs when an enterprise[5] acquires all or a portion of the net assets that constitutes a business or equity interests of one or more enterprises and obtains control over the enterprise or enterprises. Control is generally indicated by "ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company" (ARB No. 51, *Consolidated Financial Statements*, paragraph 2, as amended by FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*),

[3]Appendix F addresses the status of each EITF issue that provides guidance on the accounting for business combinations or intangible assets.

[4]The Board plans to address issues related to combinations between not-for-profit enterprises in a separate proposed Statement.

[5]For purposes of this Statement, the term *enterprise* refers to the participants in a business combination; that term can refer to any of the various forms in which the participants may exist.

although there can be exceptions to that general condition.[6] This Statement does not address transactions in which control is obtained other than through an acquisition of net assets or equity interests.[7]

11. This Statement applies to combinations involving either incorporated or unincorporated enterprises. The provisions of this Statement apply equally to a business combination in which (a) one or more enterprises are merged or become subsidiaries, (b) one enterprise transfers its net assets or equity interests to another (including all or a portion of the net assets that constitutes a business or equity interests of the enterprise), or (c) each enterprise transfers its net assets or equity interests to a newly formed enterprise. All of those transactions represent a business combination regardless of whether the form of consideration given is cash, other assets, a business or a subsidiary of the enterprise, debt, common or preferred stock, or a combination of those forms. An exchange of a business for a business also constitutes a business combination.

12. The acquisition of some or all of the equity interests held by minority stockholders of a subsidiary is not a business combination. (Paragraph 14 of this Statement specifies the appropriate method of accounting for those transactions.) The term business combination in this Statement excludes both (a) transfers by an enterprise of some or all of its net assets to a newly formed substitute enterprise chartered by the transferor enterprise and (b) transfers of net assets or exchanges of shares between enterprises under common control, such as between a parent corporation and its subsidiary or between two subsidiary corporations of the same parent. The assets and liabilities transferred in such transactions would be recorded in the accounts of the enterprise that received the net assets or shares at the amounts recorded in the accounts of the enterprise that made the transfer as of the date of the transfer or exchange. (Paragraphs 428–433 of Appendix D provide additional accounting guidance for those transactions.)

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[6]The February 1999 FASB Exposure Draft, *Consolidated Financial Statements: Purpose and Policy,* defines control as "the ability of an entity to direct the policies and management that guide the ongoing activities of another entity so as to increase its benefits and limit its losses from that other entity's activities. For purposes of consolidated financial statements, control involves decision-making ability that is not shared with others" (paragraph 6). If that proposed Statement is finalized prior to issuance of this Statement, the definition of control in that Statement will be incorporated into this Statement.

[7]The Board plans to address the accounting for other events or transactions that are similar to a business combination but do not meet this Statement's definition of a business combination (for example, joint venture arrangements) in another phase of the business combinations project. Those transactions are not currently accounted for in a manner similar to a business combination.

Method of Accounting

13. All business combinations shall be accounted for using the purchase method of accounting as described in paragraphs 66–94 of Opinion 16, as amended by this Statement and other accounting pronouncements. Business combinations shall not be accounted for using the pooling method.

14. The acquisition of some or all of the stock held by minority stockholders of a subsidiary—whether acquired by the parent, the subsidiary itself, or another affiliate—shall be accounted for by the purchase method. (Paragraphs 425–427 of Appendix D provide additional accounting guidance.)

Acquiring Enterprise

15. The acquiring enterprise is the enterprise that obtains control over the other enterprise or enterprises involved in the business combination. An enterprise that distributes cash or other assets or incurs liabilities to acquire the assets or equity interests of another enterprise and obtain control over the enterprise is clearly the acquiring enterprise. The identities of the acquiring enterprise and the acquired enterprise are usually evident in a business combination effected by the issuance of stock. The acquiring enterprise normally issues the stock and commonly is the larger enterprise. However, the facts and circumstances surrounding a business combination sometimes indicate that a smaller enterprise acquires a larger one. In addition, in some business combinations, the combined enterprise assumes the name of the acquired enterprise or it is the acquired enterprise that issues the stock (commonly referred to as a reverse acquisition).

16. In determining which enterprise is the acquiring enterprise in a business combination involving two or more enterprises, all pertinent facts shall be considered, particularly the relative voting rights in the combined enterprise after the combination and the composition of the board of directors and the senior management of the combined enterprise. In determining which of the shareholder groups retained or received the larger portion of the voting rights in the combined enterprise, the existence of any major voting blocks, unusual or special voting arrangements, and options, warrants, or convertible securities shall be considered.

17. If a new enterprise is formed to issue stock to effect a business combination, one of the existing combining enterprises shall be considered the acquiring enterprise on the basis of the evidence available. The guidance in paragraphs 15 and 16 shall be used in making that determination.

Recording Assets Acquired and Liabilities Assumed

18. An acquiring enterprise shall allocate the cost of an acquired enterprise to the assets acquired and liabilities assumed following the guidance in paragraph 68 of Opinion 16 (a process commonly referred to as the purchase price allocation). Prior to that allocation, the acquiring enterprise shall:

a. Review the purchase consideration if other than cash to ensure that it has been valued in accordance with the requirements in paragraphs 72–76 of Opinion 16.
b. Identify *all* of the assets acquired and liabilities assumed, including intangible assets. Appendix A contains an illustrative list of identifiable intangible assets that may be acquired in a business combination; use of that list as a reference tool in identifying intangible assets acquired is recommended.

19. All identifiable assets acquired and liabilities assumed in a business combination, whether or not recorded separately in the financial statements of the acquired enterprise, shall be assigned a portion of the total cost of the acquired enterprise based on their fair values at the date of acquisition.[8] Among other sources of relevant information, independent appraisals and actuarial or other valuations may be used as an aid in determining those fair values. The tax basis of an asset or liability shall not be a factor in determining its fair value. Paragraph 88 of Opinion 16 provides general guidance for assigning amounts to the individual assets acquired and liabilities assumed.

Research and Development Assets

20. This Statement does not change the requirement in paragraph 5 of FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, that amounts assigned to tangible and intangible assets to be used in a particular research and development project that *have no alternative future use* be charged to expense at the date of consummation of the combination.

Excess of Cost over the Fair Value of Acquired Net Assets

21. The excess of the cost of the acquired enterprise over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed shall be recognized as an

[8]Paragraph 93 of Opinion 16 states that the date of acquisition "should ordinarily be the date assets are received and other assets are given or securities are issued. However, the parties may for convenience designate as the effective date the end of an accounting period between the dates a business combination is initiated and consummated."

asset, commonly referred to as goodwill. Acquired identifiable intangible assets that cannot be reliably[9] measured shall be included in the amount recorded as goodwill.

22. For purposes of testing goodwill for recoverability, goodwill shall be allocated to individual asset groups in accordance with paragraph 12 of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* as of the acquisition date.[10] That is, goodwill shall be allocated to asset groups on a pro rata basis using the relative fair values of the long-lived assets and identifiable intangible assets acquired, unless there is evidence that some other method of associating the goodwill with those assets is more appropriate. That allocation shall be completed and support for it documented at the time the purchase price allocation is completed. FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises,* states that the purchase price allocation should usually be completed within one year from the acquisition date.

Excess of the Fair Value of Acquired Net Assets over Cost

23. In some cases, the sum of the fair values of identifiable assets acquired less liabilities assumed may exceed the cost of the acquired enterprise (*excess of the fair value of acquired net assets over cost* or *excess*). In those cases, the amounts that otherwise would be assigned to acquired intangible assets that are of a type that do not have an observable market (as defined in paragraph 34) shall be limited to the amount that would not create or increase an excess. If the excess is less than the fair values of those acquired intangible assets, it shall be allocated as a pro rata reduction of the fair values that otherwise would be assigned. If the excess is greater than the fair values of those intangible assets, the remaining excess shall then be allocated as a pro rata reduction of the fair values that otherwise would be assigned to all of the acquired depreciable nonfinancial assets and all of the acquired intangible assets that are of a type that have an observable market.

24. If any excess remains after those assets are reduced to zero, that excess shall be recognized as an extraordinary gain as described in paragraph 11 of APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of*

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[9]Reliability embodies the characteristics of representational faithfulness and verifiability, as discussed in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* and does not mean that intangible assets must be precisely measurable.

[10]The Board is currently addressing certain issues related to the provisions in Statement 121 in its project on asset impairment and disposal issues. A proposed Statement incorporating the Board's decisions on those issues is expected to be issued in the fourth quarter of 1999. Some of the provisions in Part II of this Statement related to reviewing goodwill for impairment may be incorporated into the Statement affecting Statement 121, depending on when that Statement is issued in relation to the issuance of this Statement.

a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. The extraordinary gain shall be recognized in the period in which the purchase price allocation is completed.

Accounting for Goodwill and Other Intangible Assets Acquired

25. After initial recognition, goodwill and other intangible assets acquired in a business combination shall be accounted for in accordance with the provisions of Part II of this Statement.

26. If at the date of acquisition more than one of the following factors is present in the business combination transaction, goodwill shall be tested for recoverability no later than two years after the acquisition date in accordance with paragraph 48.

a. A significant premium was paid over the market capitalization[11] of the acquired enterprise prior to the start of acquisition discussions.
b. The acquisition involved a clearly visible auction or bidding process.
c. The amount of goodwill was significant relative to the cost of the acquired enterprise.
d. The purchase consideration was primarily in the form of the acquiring enterprise's shares.

Disclosures

27. The notes to the financial statements of an acquiring enterprise shall disclose the following information in the period in which a material business combination is completed:

a. The name and a brief description of the acquired enterprise and the percentage of voting shares acquired
b. The period for which the results of operations of the acquired enterprise are included in the income statement of the acquiring enterprise
c. The cost of the acquired enterprise and, if applicable, the number of shares of stock issued or issuable, the value assigned to those shares, and the basis for determining that value
d. Contingent payments, options, or commitments specified in the acquisition agreement and the accounting treatment that will be followed should any such contingency occur
e. A condensed balance sheet disclosing the following for each major asset and liability caption of the acquired enterprise: (1) the book value as reflected in the acquired en-

[11]For purposes of this Statement, market capitalization is the market price of a company's outstanding stock multiplied by the number of shares outstanding.

terprise's financial records at the date of acquisition before fair value adjustments and (2) the fair values assigned at the date of acquisition (as determined in accordance with paragraph 19 and possibly as adjusted in accordance with paragraph 23)

f. For any purchase price allocation that has not been finalized, that fact and the reasons therefor[12] and, in subsequent periods, the nature and amount of any material adjustments made to the initial allocation of the purchase price
g. The information described in paragraph 60 if the amount assigned to goodwill or to other intangible assets acquired is significant in relation to the total cost of the acquired enterprise.

Illustration 2 in Appendix C provides an example of those disclosures.

28. The notes to the financial statements of an acquiring enterprise shall disclose the following information in the period in which individually immaterial business combinations have been completed if those combinations are material in the aggregate:

a. The number of enterprises acquired and a brief description of those enterprises
b. The aggregate cost of the acquired enterprises, the number of shares of stock issued or issuable, and the value assigned to those shares
c. The aggregate amount of any contingent payments, options, or commitments and the accounting treatment that will be followed should any such contingency occur (if potentially significant in relation to the aggregate cost of the acquired enterprises)
d. The information described in paragraph 60 if the aggregate amount assigned to goodwill or to other intangible assets acquired is significant in relation to the aggregate cost of the acquired enterprises.

Illustration 3 in Appendix C provides an example of those disclosures.

29. The notes to the financial statements also shall disclose, for any material business combination completed after the balance sheet date but before the financial statements are issued, the information required by paragraph 27 (unless not practicable).

Part II: Intangible Assets

Scope

30. Part II of this Statement applies to the accounting for both identifiable and unidentifiable intangible assets that an enterprise acquires and recognizes as assets, including

[12]Statement 38 addresses this issue.

those acquired in a business combination. This Statement applies to any intangible assets recorded on the acquisition of some or all of the equity shares held by minority stockholders of a subsidiary company.

31. Part II of this Statement also covers the accounting for costs of developing goodwill and other unidentifiable intangible assets with indeterminate lives. The provisions of this Statement apply to costs of developing identifiable intangible assets that an enterprise recognizes as assets. Some enterprises capitalize costs incurred to develop identifiable intangible assets while others expense the costs when incurred.[13]

32. Part II of this Statement does not apply to intangible assets whose accounting is prescribed by:

a. FASB Statement No. 2, *Accounting for Research and Development Costs*
b. FASB Statement No. 61, *Accounting for Title Plant*
c. FASB Statement No. 63, *Financial Reporting by Broadcasters* (license agreements for program material, paragraphs 2–7)
d. FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* (paragraph 7)
e. FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (servicing rights, paragraph 13).

33. The intangible assets addressed in the following accounting pronouncements are included in the scope of this Statement; however, except as described in Appendix E, Part II of this Statement does not change the guidance provided in those pronouncements:

a. FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers*
b. FASB Statement No. 50, *Financial Reporting in the Record and Music Industry*
c. FASB Statement No. 51, *Financial Reporting by Cable Television Companies*
d. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation* (paragraphs 29 and 30)
e. FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions* (paragraphs 4–7)
f. FASB Interpretation No. 9, *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method.*

[13]This paragraph has been carried forward from Opinion 17 without reconsideration by the Board.

Definitions

34. The following terms and definitions are used in this Statement:

a. Intangible assets—intangible assets are noncurrent assets (not including financial instruments) that lack physical substance.
b. Goodwill—the amount recognized as goodwill may consist of one or more unidentified intangible assets and identifiable intangible assets that are not reliably measurable. The elements of goodwill have varying useful economic lives. Examples of elements of goodwill include new channels of distribution, synergies of combining sales forces, and a superior management team.[14] Because those and similar elements cannot be reliably measured separately from each other, they are accounted for collectively as goodwill.
c. Observable market—for purposes of applying this Statement, an observable market is one in which intangible assets are separately bought and sold, even though such transactions may be infrequent. From those purchase and sale transactions, a market price can be observed and used in estimating the fair value of intangible assets that are similar.

Acquisition of Intangible Assets

35. An enterprise shall recognize any intangible assets acquired from other enterprises or individuals whether those assets are acquired singly, in groups, or as part of a business combination and shall initially measure those assets based on their fair value.[15] Principles of and procedures for determining the fair value of assets acquired in a business combination, including intangible assets, are discussed in detail in paragraphs 66–88 of Opinion 16 (as amended by this Statement).[16]

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[14]Refer to Appendix A for more examples.

[15]As noted in paragraph 20, Interpretation 4 requires amounts assigned to intangible assets that are to be used in a particular research and development project and that *have no alternative future use* to be charged to expense at the date of consummation of a business combination. This Statement does not change that requirement.

[16]Although those paragraphs refer to determining the cost of the assets acquired, both paragraph 67 of Opinion 16 and paragraph 18 of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, note that, in general, cost should be measured based on "the fair value of the consideration given or by the fair value of the property acquired, whichever is the more clearly evident" (paragraph 67 of Opinion 16; footnote references omitted).

Internally Developed Intangible Assets

36. Costs of internally developing, maintaining, or restoring intangible assets that are not specifically identifiable, have indeterminate lives, or are inherent in a continuing business and related to an enterprise as a whole shall be recognized as an expense when incurred.[17]

Amortization of Intangible Assets Other Than Goodwill

37. Reliably measurable identifiable intangible assets other than those intangible assets that meet the criteria for nonamortization in paragraph 41 shall be amortized over their useful economic lives. The useful economic life of an intangible asset shall be presumed to be 20 years or less. Paragraph 44 provides guidance for determining the useful economic life of an intangible asset. Appendix A includes a diagram illustrating the provisions for amortizing intangible assets.

38. The amount of an identifiable intangible asset to be amortized shall be the amount assigned less any residual value. The residual value of an intangible asset shall be assumed to be zero unless the useful life to the acquiring enterprise is shorter than the asset's useful economic life generally and (a) the acquiring enterprise has a commitment from a third party to purchase the asset at the end of its useful life or (b) the residual value can be determined by reference to an observable market for that asset and that market is expected to exist at the end of the asset's useful life.

39. The method of amortization shall reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight-line amortization method shall be used. An intangible asset shall not be written off in the period of acquisition unless it becomes impaired due to changes in circumstances or events occurring during that period.

40. The presumption that an intangible asset has a useful economic life not longer than 20 years may be overcome if the intangible asset generates clearly identifiable cash flows that are expected to continue for more than 20 years and either the asset is exchangeable or control over the future economic benefits of the asset is obtained through contractual or other legal rights that extend for more than 20 years.[18] Clearly identifiable cash flows are cash flows that may be associated with the specific intangible asset or with a group of assets that includes the intangible asset. Appendix A includes illustrative examples of different intangible assets and how they should be accounted for in accordance with Part II of this Statement.

[17] This paragraph has been carried forward from Opinion 17 without reconsideration by the Board.

[18] Refer to the guidance in paragraph 44(b).

Nonamortization of Certain Intangible Assets

41. If an intangible asset meets the criteria in paragraph 40 for overcoming the 20-year useful life presumption, is of a type that has an observable market, and is determined to have an indefinite useful economic life that is not otherwise limited, it shall not be amortized until its life is determined to be finite. An intangible asset that meets those criteria shall be reviewed for impairment annually in accordance with paragraph 50. An intangible asset that is assessed as having an indefinite useful economic life but is of a type that does not have an observable market shall be amortized over a finite period. Appendix A includes illustrative examples of different intangible assets and how they should be accounted for in accordance with Part II of this Statement.

Amortization of Goodwill

42. All goodwill shall be amortized over its useful economic life, but not over a period longer than 20 years. The useful economic lives of the underlying elements of goodwill shall be considered in determining the amortization period for goodwill. While determining the amortization period for goodwill involves judgment, the period selected shall not be unrealistically long or short. The guidance in paragraphs 44 and 45 shall be used in determining and evaluating the useful economic lives of the elements of goodwill.

43. Goodwill shall be amortized on a straight-line basis unless another systematic method can be demonstrated to be more appropriate and the resulting amortization charge in the early years is no less than it would be under a straight-line method. Goodwill shall not be written off in the period of acquisition unless it becomes impaired due to changes in circumstances or events occurring during that period.

Determining the Useful Economic Life

44. The useful economic life of an intangible asset is the period over which the asset is expected to generate future economic benefits (that is, the period over which the asset generates identifiable cash flows).[19] The following factors shall be considered in estimating the useful economic life of an intangible asset:

a. The legal, regulatory, or contractual provisions that may limit the maximum useful life

[19]The period of time that it would take to internally develop an intangible asset that will provide similar benefits should not be considered in determining the useful economic life of the intangible asset because it is not indicative of the period of economic benefit.

b. The legal, regulatory, or contractual provisions that may enable renewal or extension of a specified limit on the asset's legal or contractual life (provided there is evidence to support renewal or extension without substantial cost)
c. The effects of obsolescence, demand, competition, and other economic factors (such as the stability of the industry, the rate of technological change, and expected changes in distribution channels)
d. The expected useful life of assets or groups of assets of the enterprise or of individuals or groups of employees to which the useful life of the asset may parallel (such as mineral rights to depleting assets)
e. The expected use of the intangible asset by the enterprise
f. The level of maintenance expenditure required to obtain the expected future economic benefits from the asset (for example, if the level of required maintenance is material in relation to the carrying value of the asset, that may suggest a very limited useful life).[20]

Analysis of all factors should result in a reasonable estimate of the useful economic life of an intangible asset.

45. An enterprise shall evaluate the remaining periods of amortization every reporting period to determine whether events and circumstances warrant revised estimates of useful economic lives. If estimates are changed, the unamortized cost shall be allocated to the increased or reduced number of remaining periods in the revised life. However, the total amortization period for goodwill or an intangible asset may never exceed 20 years (except for an identifiable intangible asset that meets the criteria in paragraph 40 for overcoming the 20-year useful life presumption).

Impairment

Goodwill and Other Intangible Assets Subject to Amortization

46. Goodwill and other intangible assets that are subject to amortization shall be reviewed for impairment in accordance with Statement 121 by applying the recognition and measurement provisions in paragraphs 4–11 of that Statement. In accordance with Statement 121, an impairment loss is recognized if the carrying amount of an asset is not recoverable and its carrying amount exceeds its fair value.

47. Paragraph 5 of Statement 121 provides examples of events or changes in circumstances that indicate that the carrying amount of an asset may not be recoverable. The

[20]As in determining the economic life of depreciable tangible assets, regular maintenance may be assumed, but not enhancements.

following are additional examples of events or circumstances that indicate that the carrying amount of goodwill may not be recoverable.

a. The carrying amount of the net assets of the reporting enterprise is more than its market capitalization at the balance sheet date.
b. A significant decrease in the stock price of either the acquired or the acquiring enterprise since the date of acquisition if that decrease is not consistent with changes in the overall market.
c. The probability of the occurrence of an assumed event that was significant in setting the acquisition price has changed significantly from the time the price was set.
d. An unfavorable change in the status of or expectations about one or more of the underlying elements of goodwill.

In addition, paragraph 26 of this Statement includes factors that if present at the date of acquisition would require goodwill to be tested for recoverability no later than two years after the acquisition date.

48. If events or circumstances indicate that goodwill should be tested for recoverability, that test shall be performed at the individual asset-group levels to which goodwill has been allocated[21] until all of the goodwill has been tested. However, if events or circumstances indicate that a specific asset or asset group should be reviewed for impairment and that asset or asset group was acquired in a business combination, the review of goodwill for impairment may be limited to the goodwill allocated to the specific asset or asset group under review.

Disposal of goodwill

49. Ordinarily, goodwill cannot be disposed of apart from the enterprise as a whole. However, if a large segment or separable group of assets of an acquired enterprise or the entire acquired enterprise is sold or otherwise liquidated, all or a portion of the unamortized cost of the goodwill recognized in the acquisition shall be included in the cost of the assets sold.[22]

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[21]Refer to paragraph 22.

[22]This paragraph has been carried forward from Opinion 17 without reconsideration by the Board. The Board is addressing goodwill associated with assets to be disposed of as part of its project on asset impairment and disposal issues. The Board expects to issue a proposed Statement that will provide guidance on that issue in the fourth quarter of 1999.

Intangible Assets Not Subject to Amortization

50. An intangible asset not being amortized (in accordance with paragraph 41) that is being held and used shall be reviewed for impairment annually, and an impairment loss shall be recognized if the carrying amount of that intangible asset exceeds its fair value. The observed market price shall be used in estimating the fair value of the intangible asset. In addition, the guidance in paragraphs 7 and 9 of Statement 121 shall be applied in determining fair value and in measuring the amount of the impairment loss. After an impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be the new accounting base for the asset and any recovery in its value shall not be recognized.

Financial Statement Presentation

51. All goodwill shall be aggregated and presented as a separate line item in the statement of financial position. At a minimum, all other intangible assets shall be aggregated and presented as a separate line item in the statement of financial position. However, that requirement does not preclude presentation of individual intangible assets or classes of intangible assets as separate line items. Illustration 1 in Appendix C provides an example of that presentation.

52. Goodwill amortization expense and goodwill impairment losses (collectively referred to as "goodwill charges") shall be presented on a net-of-tax basis as a separate line item in the income statement. All enterprises reporting goodwill charges shall display a subtotal, after income taxes but before goodwill charges, that is descriptive of the items that follow; for example, *income before goodwill charges and extraordinary item* or *income before goodwill charges and discontinued operations*. That subtotal shall be followed by the line item for goodwill charges that in turn shall be followed by a subtotal that is descriptive of the other items that follow; for example, *income before extraordinary item* or *income before discontinued operations*. If there are no other items that follow, the goodwill line item shall be followed by the total *net income* (or a similar caption). Illustration 1 in Appendix C provides an example of that presentation.

53. Goodwill charges associated with a discontinued segment shall be included (on a net-of-tax basis) within the results of discontinued operations. If goodwill impairment losses are associated with extraordinary items or changes in accounting principle, those losses shall be included as part of those line items in the income statement as appropriate.

54. The amortization expense and impairment losses for intangible assets other than goodwill shall be presented in income statement line items as deemed appropriate for each

enterprise. Those charges may not be presented on a net-of-tax basis in a manner similar to the goodwill charges and they should be included in the subtotal of income that precedes the goodwill charges.

Income Tax Allocation

55. Paragraph 35 of FASB Statement No. 109, *Accounting for Income Taxes*, provides guidance on allocating income tax expense or benefit for the period among continuing operations, discontinued operations, extraordinary items, and so forth. In accordance with that paragraph, the amount allocated to continuing operations is the tax effect of the pretax income or loss from continuing operations that occurred during the year, plus or minus income tax effects of four specified items. For purposes of applying that provision in periods in which goodwill charges have been recognized, *pretax income or loss from continuing operations* includes goodwill charges on a pretax basis.

56. Goodwill charges shall be presented on a net-of-tax basis.[23] The portion of income tax expense or benefit attributable to pretax income or loss from continuing operations that is to be allocated to goodwill charges shall be determined by applying a "with and without" computation. That computation results in measuring the tax effect of goodwill charges at the highest marginal tax rate or rates. Illustration 1 in Appendix C provides an example of that presentation.

Per-Share Amounts

57. Enterprises may present basic and diluted per-share amounts on the face of the income statement for the subtotal on the income statement that precedes the goodwill charges and for the goodwill charge line item. Those amounts shall be computed in accordance with FASB Statement No. 128, *Earnings per Share*, and shall be presented with no greater prominence than the per-share amounts required to be presented on the face of the income statement in accordance with paragraph 36 of Statement 128. Illustration 1 in Appendix C provides an example of that presentation.

58. Paragraph 15 of Statement 128 states that income from continuing operations is the "control number" to be used in determining whether potential common shares are dilutive or antidilutive for an enterprise with a discontinued operation, an extraordinary item, or the cumulative effect of a change in accounting principle. For purposes of applying that provision in periods in which goodwill charges have been recognized, *income from continuing operations* (the control number) refers to the subtotal of income immediately following those goodwill charges.

[23]Goodwill charges may be deductible for tax purposes in taxable business combinations and therefore give rise to tax benefits.

Terminology

59. The phrase *income from continuing operations* is used throughout the accounting literature to refer to the subtotal on the income statement that precedes discontinued operations, extraordinary items, and accounting changes. However, use of that caption is not required and many enterprises do not use it in their income statements, especially when discontinued operations are not present. Whenever that phrase is found in accounting pronouncements, it should be considered to refer to the subtotal of income immediately following the goodwill charges.

Disclosures

60. The notes to the financial statements shall disclose in the year of acquisition the following information as of the acquisition date:[24]

a. For each class[25] of intangible asset:
   (1) A description of the assets and their recorded amounts
   (2) The key assumptions and methodologies used to value the intangible assets
   (3) A description of and, if other than straight-line, the reason for the amortization method
   (4) The weighted-average amortization period
   (5) Any residual value assumed in determining the amount to be amortized (if significant in relation to the carrying amount of the intangible asset class)
b. A description and the carrying amount of any significant intangible asset presumed to have either a useful economic life longer than 20 years or an indefinite life, the useful life assigned, and the factors supporting that life
c. For goodwill:
   (1) A description of the elements that underlie goodwill
   (2) The amortization period for goodwill and how it was determined
   (3) The amortization method.

Illustrations 2 and 3 in Appendix C provide examples of those disclosures.

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[24]Paragraph 27(g) provides additional guidance on disclosures required for intangible assets acquired in a business combination.

[25]A class is a group of assets of a similar nature and use in an enterprise's operations.

61. The financial statements shall disclose the following information.

a. For each class of intangible asset:
   (1) The gross carrying amount
   (2) The accumulated amortization
   (3) The current-period amortization expense
   (4) The amortization method
b. A description of any intangible asset not being amortized and a description of the method used to estimate the fair value of that asset
c. For all goodwill:
   (1) The accumulated amortization
   (2) The amortization method.

Illustrations 2 and 4 in Appendix C provide examples of those disclosures.

62. An enterprise that recognizes an impairment loss related to goodwill or other intangible assets, including intangible assets not subject to amortization, shall disclose the information required by paragraph 14 of Statement 121 in the financial statements that include the period of the impairment loss.

Effective Date and Transition

63. The provisions of Part I of this Statement shall be effective for business combinations initiated after the issuance date of this Statement. The provisions of Part II of this Statement shall be effective for intangible assets (including goodwill) acquired in transactions initiated after the issuance date of this Statement. The following definition of *initiated* from paragraph 46 of Opinion 16 shall be used in determining the effective date of this Statement.

> A plan of combination is initiated on the earlier of (1) the date that the major terms of a plan, including the ratio of exchange of stock, are announced publicly or otherwise formally made known to the stockholders of any one of the combining companies or (2) the date that stockholders of a combining company are notified in writing of an exchange offer. Therefore, a plan of combination is often initiated even though consummation is subject to the approval of stockholders and others.

Any alteration in the terms of the exchange in a plan of combination constitutes initiation of a new plan of combination. Paragraphs 420–424 of Appendix D provide additional guidance relating to the definition of initiated.

64. The unamortized balance of goodwill that was being accounted for in accordance with ARB No. 43, Chapter 5, “Intangible Assets,” at the date this Statement was issued shall be written off in the first interim or annual period ending after the issuance date of this Statement. The effect of that write-off shall be reported in a manner similar to the cumulative effect of a change in accounting principle as described in paragraph 20 of APB Opinion No. 20, *Accounting Changes*. The pro forma effects of retroactive application (discussed in paragraph 21 of Opinion 20) shall not be disclosed.

65. Except as described in paragraphs 64 and 66, intangible assets (including goodwill) recognized as a result of transactions that were initiated prior to the issuance date of this Statement (previously recognized intangible assets) shall be accounted for in accordance with whichever pronouncement (ARB 43, Chapter 5 or Opinion 17) was being applied at the date this Statement was issued. The provisions in this Statement related to amortization and nonamortization of intangible assets may not be retroactively applied to previously recognized intangible assets.

66. The provisions in this Statement related to financial statement presentation (paragraphs 51–58) and disclosures (paragraphs 60–62) shall be applied to previously recognized intangible assets (including goodwill) beginning in the first interim or annual period ending after the issuance date of this Statement unless it is not practicable to do so. If comparative financial statements are provided for earlier periods, those financial statements (including interim financial statements, summaries of earnings, and selected financial data) shall be reclassified to reflect application of the financial statement presentation and disclosure provisions of this Statement. The impairment provisions of this Statement (paragraphs 22 and 46–49) shall be applied to previously recognized intangible assets (including goodwill) being accounted for in accordance with Opinion 17. If previously recognized goodwill cannot be allocated to asset groups as prescribed in paragraph 22, some other reasonable allocation method shall be used.

The provisions of this Statement need not be applied to immaterial items.